FILE COPY

No. 184. October Term, 1924

FILED
JAN 14 1925
WM. R. STANSBURY
CLERK

IN THE

Supreme Court of the United States

EPHRAIM LEDERER, Collector of Internal Revenue for the First District of the State of Pennsylvania, Petitioner

v.

FIDELITY TRUST COMPANY

On certiorari to the United States Circuit Court of Appeals for the Third Circuit

---

BRIEF FOR RESPONDENT

H. GORDON MCCOUCH,
JAMES MCMULLAN,
750 Bullitt Building,
Philadelphia
Attorneys for Respondent

DAVIS & SONS, Printers
Phila.

IN THE

Supreme Court of the United States

No. 184, October Term, 1924

EPHRAIM LEDERER, Collector of Internal Revenue for the First District of the State of Pennsylvania, petitioner

v.

FIDELITY TRUST COMPANY

On Certiorari to the United States Circuit Court of Appeals for the Third Circuit

ARGUMENT FOR RESPONDENT

The question for determination is whether equipment trust certificates issued under what is known as the Philadelphia Plan (Record 10) are subject to stamp taxes under the Revenue Act of 1918.

It is necessary at the outset to remember that there are various forms of equipment trust certificates, some of which, being notes or bonds of the

Railroad Company, lessee, are obviously certificates of indebtedness and subject to stamp tax; but the certificates in the case at bar do not fall within this category. This form was devised more than thirty years ago with the distinct object in view of creating a certificate of ownership—not one of indebtedness—and therefore not liable in the hands of holders to taxation under the then laws of the State of Pennsylvania.

For a proper consideration of this subject it is essential that a clear understanding be had of the nature of such certificates.

A railroad company, needing additional rolling stock, goes to its banker, who undertakes to arrange for the building of the cars needed according to specifications furnished and the hiring of the same to the railroad company under a form of bailment, by which, on payment of all rental reserved, the railroad company is given the option to purchase the equipment for one dollar. The operation is financed by the banker arranging with a trust company to receive subscriptions for the purchase of the desired rolling stock, to contract with the car builders for the purchase of the

same, and as agent for the owners to lease the equipment to the railroad company at rentals agreed upon, and to issue to the subscribers certificates evidencing their equitable ownership and certifying that out of the rentals to be received by the trustee the holders will be entitled to the amount of such certificate with dividends as stated.

It is to be observed that the certificate is not a certificate of indebtedness; that there is no debtor; that it is merely the declaration of the trustee, as agent of the holder of the certificate, that it will collect for his benefit and that of other owners the rentals expressed in the lease and distribute the same pro rata. If not paid at maturity no action of debt would lie upon such certificate.

The Government devotes the first part of its argument to showing that equipment certificates are frequently referred to by writers on economics and finance as bonds or notes or corporate securities.*

---

*The reference to page 16 of Kenneth Duncan's book on "Equipment Obligations" for a discussion of the "Philadelphia Plan" is somewhat unfortunate. Mr. Duncan fell into the common error of supposing that those words referred to the bailment of the cars, instead of to the form of the equipment certificate. His attention was called to the matter and he stated that he would revise what he had written if a second edition of his book were printed.

Such description is quite proper where the certificates referred to are the direct obligation of the Railroad Company lessee, but not where the certificates are in the form of those taxed in the case at bar.

The Government then states its position as follows: "This Court and other Federal Courts, whenever instruments of this class have come before them, have always looked beyond the particular form to the real substance of the transaction; and we think the following cases show that **the form of the agreement is for practical purposes immaterial and taxation is certainly a most practical purpose.**"

This is followed by a review of cases in which the question at issue was whether the contract with the railroad company for the use of the equipment was valid as a bailment or a conditional sale.

We submit that this statement of the law, however pertinent to the matters at issue in the cases referred to, is, when applied to the case at bar, directly at variance with the decision of this Court in **United States v. Isham,** 84 U. S. 496,

that the liability of an instrument to stamp duty is determined by *the form and face of the instrument.* The learned Judge of the District Court, before whom the case was tried, fell into the same error, and we shall hereafter advert to it more particularly.

The tax here in question was imposed under the Revenue Act of 1918, Sub-division 1, Schedule A, Title XI, Stamp Taxes, which reads:—

> "I. Bonds of Indebtedness: On all bonds, debentures or certificates of indebtedness issued by any person, and all instruments, however termed, issued by any corporation with interest coupons or in registered form known generally as corporate securities, on each one hundred dollars of face value or fraction thereof five cents: Provided, That every renewal of the foregoing shall be taxed as a new issue: Provided further, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured."

The Section of the Act under which the tax is sought to be imposed is entitled "Bonds of Indebtedness." It taxes instruments which are recognized evidences of indebtedness when issued by an individual, and as to corporate indebtedness it uses the words "all instruments, however termed, issued by any corporation with interest coupons or in registered form known generally as corporate securities."

As a matter of grammatical construction and of common sense reading of the words of the statute, to what can the words "corporate securities" relate other than to "instruments issued by any corporation with interest coupons or in registered form"? This more clearly appears if we transpose the two qualifying parenthetical sentences, thus, "and all instruments issued by any corporation with interest coupons or in registered form, however termed, known generally as corporate securities."

The words of the statute are definite, precise, grammatically expressed and free from ambiguity. The tax is imposed on "all instruments (however termed) issued by any corporation

(with interest coupons or in registered form) known generally as corporate securities."

The equipment certificate here taxed is not a certificate of indebtedness or a corporate security. It is not the obligation of a corporation to pay money owing by it, nor does it evidence an indebtedness secured on the property of a corporation. It is a mere declaration of trust and defines the holder's ownership of the equipment leased to the railroad company and the extent of his interest in the moneys to be received as rental therefor. Neither the railroad company nor the trust company is indebted to the certificate holders. The railroad company is obligated to pay rental for the use of certain equipment, and the trustee, to which such rental is paid, has to turn over to each certificate holder his proportionate share when and as received.

The certificate is merely the evidence of the holder's equitable ownership of an undivided interest in the equipment leased to the railroad company and the rentals payable therefor. How, then, can such muniments of title be termed "corporate securities"?

Interest is an attribute of a debt. The dividend warrants attached to the equipment certificates are not interest coupons and do not purport to be such.

The reference in this clause of the Act to renewals is also instructive. There can be no newals of a contract of bailment of the cars with option to purchase. Either the railroad company becomes the owner of the cars, or the owners repossess themselves of their property. If a new arrangement is made, a new contract would have to be entered into and recorded as provided in the Car Trust Statutes.

The last provision of this Section—"Provided further, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured"—also shows that the instruments to be taxed are those which evidence a debt and provide for its payment.

The learned Judge before whom the case was tried in his first opinion (Record 23) said:

> "The certificate is not within the literal verbiage of the Act of Congress, not being 'a

> **certificate of indebtedness issued by any person' nor 'an instrument issued by any corporation.'** If the taxing hand has been laid only upon these specific forms of what are generally known as securities it must be withdrawn from the 'trust certificates' now under view. This would mean that they are the exceptions among the general class of securities and are exempt because the very effort made in the framing of the law to include all forms of securities of this general character has, in verbal nicety, excluded them."

This confirms our contention that these certificates were not "issued" by the Fidelity Trust Company within the meaning of that word as used in *the statute.*

Edwards v. Chile Copper Co., 273 Fed. 452.

They are not the "securities of the Fidelity Trust Company." There would be no difference whatsoever in the form of the certificate or in its legal effect if there were an individual trustee instead of a corporate trustee.

To hold otherwise would lead to the absurd result that where the trustee was a corporation the certificate would be taxable, but that if an individual was trustee it would not.

The opinion then, however, continues as follows (Record 23):

> "The Act of Congress, however, includes more than the two kinds of securities mentioned because we think it includes everything known generally as corporate securities";

but the writer frankly adds (Record 24):

> "There are two obstacles to be surmounted before reaching this construction. One is that the rule of the nearest antecedent makes the quoted phrase relate to and serve as a definition of the described kinds of 'instruments issued by corporations,' and the other is that the finding of a meaning to tax all instruments 'commonly known as corporate securities' involves the presence of a grammatical error in the Act of Congress."

Without attempting to meet these objections he contents himself with saying (Record 24):

> "Neither of these obstacles are however insurmountable, if this was the meaning of Congress, and we so find."

It is thus entirely clear that the learned Judge did not and could not find that the statute **IN WORDS** imposed a tax on the certificates here in question. Convinced, however, that Congress intended to tax them, he sought to demonstrate that if not taxed in specific form they are, when analyzed, in effect in the same class as those so taxed. This is evident from the concluding passage of his first opinion, where he says (Record 24):

> "The real truth back of the whole discussion is that if these certificates are not taxable, it is because of the accidental circumstance of a wholly nominal separation of the security held by the taxpayer from the obligation of debt entered into by the carrier corporation. The real security is the promise not of one corporation but of two

to pay to the certificate holders the sums due them. The real transaction is the request of the carrier company made to the certificate holders to advance the money required for payment, in consideration of which the carrier agrees to pay back the sum advanced, with interest. **THIS IT IS TRUE WAS NOT THE FORM OF THE PROMISE,** but such it was in substance because it was a promise to pay a sum which was the exact (and not accidental but prefixed) equivalent of the advances, with interest."

And so the Government here contends.

But this is directly at variance with the decision in **United States v. Isham,** 84 U. S. 496, that the liability of an instrument to stamp duty is determined by the form and face of the instrument.

It cannot be successfully contended that these certificates are within the literal wording of the Act of Congress, and the law forbids extending the provisions of the Act beyond the clear import of the language used.

In the second opinion of the trial judge (Record 16) he says:

> **"We have already found, and now repeat the finding, that as we read this Act of Congress these certificates are not among the taxable things which Congress, by the verbiage employed, has expressly named, and that the words 'commonly known as corporate securities' cannot be read to refer to these certificates without ignoring the rule of reference to the nearest antecedent nor without imputing to Congress a grammatical error."**

Notwithstanding that he has thus found that the certificates in the case at bar are not "corporate securities" he goes outside of their wording and proceeds to argue that they really are in effect such and seemingly confuses the equipment trust certificates with the lease or bailment of the cars made by the trustee to the railroad company. Then again, because some equipment certificates are in the form of certificates of indebtedness, and therefore within the purview of the Act, he argues that other equipment certificates which do not evidence an indebtedness must also be con-

sidered as included. In other words, he treats the act as though it had imposed a stamp tax on all equipment trust certificates and respondent were seeking to avoid the payment of the tax because these equipment trust certificates were drawn under what is known as the Philadelphia Plan. Thus he says (Record 20):

> "We adhere also to the view that these car trust certificates are taxable just as other car trust certificates are taxable, because they are in reality, although not in form, the same as the others. They are all alike car trust certificates."

And this is the Government's position on this appeal.

Petitioner claims the right to look "beyond the particular form to the real substance of the transaction" and that "the form of the agreement is for practical purposes immaterial and taxation is certainly a most practical purpose."

Both ignore the fact that the law for construing Acts of Congress imposing stamp duties is the very opposite of the view for which they contend.

United States v. Isham, 84 U. S., 496, at page 504:

"The liability of an instrument to stamp duty, as well as the amount of such duty, is determined by the form and face of the instrument, and cannot be affected by proof of facts outside of the instrument itself.

"If there is a doubt as to the liability of the instrument to taxation, the construction is in favor of the exemption, because, in the language of Pollock, C. B. in **Girr v. Scudds** (11 Exchequer 191) 'a tax cannot be imposed without clear and express warrant for that purpose.'"

In **Gould v. Gould,** 245 U. S. 151, the Court laid down this rule:

"In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen. **United States v. Wigglesworth,** 2

Story, 369; **American Net & Twine Co. v. Worthington,** 141 U. S. 468, 474; **Renzinger v. United States,** 192 U. S. 38, 55."

In the very recent case of **United States v. Merriam,** 263 U. S. 179, Mr. Justice Sutherland, speaking for the Court, specifically negatives the contention of Petitioner in these words:

> "On behalf of the government it is urged that taxation is a practical matter, and concerns itself with the substance of the thing upon which the tax is imposed, rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer. **Gould v. Gould,** 245 U. S. 151, 153, 62 L. ed. 211, 213, 38 Sup. Ct. Rep. 53. The rule is stated by Lord Cairns in **Partington v. Atty. Gen.,** L. R. 4 H. L. 100, 122. 'I am not at all sure that in a case of this kind—a fiscal case—form is not

amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.' And see **Eidman v. Martinez,** 184 U. S. 578, 583, 46 L. ed. 697, 701, 22 Sup. Ct. Rep. 515."

As pointed out in the opinion of the Circuit Court of Appeals:

> "Car trust certificates **such as here involved,** have been so long and so largely used in the financial world and are so vital a factor in the financing and equipment of rail-

> roads, that it would seem that Congress, had it intended taxing them, would have so covered them by specific designation or by proper generic description, as to leave no question of its intent."

It is apparent, on inspection of the **form and face of the certificate,** that it is not subject to stamp tax **within the clear import of the words of the statute,** and it is respectfully submitted that the appeal should be dismissed with costs.

H. GORDON MCCOUCH,
JAMES MCMULLAN,
Attorneys for Respondent